

## Lease vs. Buy

Everything You Always Wanted To Know But Didn't Know Who To Ask

### Paying Cash: The Concept !

Most people pay cash because they have it. There it is, sitting there in the bank just waiting to be spent on something productive like some new equipment. Besides, if you pay cash for that new equipment, you don't have to mess with those pesky monthly payments. Additionally, since I own the equipment, I can depreciate it which is a great write-off that helps lower my taxes. It sure sounds like paying cash for that new equipment is an excellent way to go.

### Paying Cash: The Fallacy !

Many times an example makes the point best, so let's use an example to make a very important point here. Let's assume your Son comes to work for you. You have agreed to hire him for \$40,000 per year because in your analysis you have determined that his employment will either make you or save you an amount in excess of that. Now he comes to you and agrees to sign a binding Contract of employment where he promises to work for you for the next 5 years under well defined conditions, and as a result he wants his 5 year salary of \$200,000 right now. I assume you would decline his offer (if not, please call me) because as a good businessman you are aware of two basic concepts that come into play here: (1) you are going to pay him out of the cash flow he makes or saves you; and (2) why pay in today's Dollars what you can pay in tomorrow's Dollars. This same concept is as basic to purchasing equipment as it is to hiring employees. You should let the equipment pay for itself out of the cash flow it generates for you over its useful life, and use inflated Dollars to do it.

Following are a few other points to consider in the Cash-Fallacy:

#### Depreciation

The initial perceived advantage to depreciation must be weighed against, the effects of recapture at the time of sale (very simply stated, paying taxes on the depreciation amount that equals the sales price), and what it does to your AMT (Alternative Minimum Tax) calculations.

#### Pre-Tax & Post-Tax Dollars

When you pay cash for an equipment purchase, you do so with post-tax Dollars (Dollars you have paid tax on). When you lease equipment, you use pre-tax dollars. Since the average company is in the 34% tax bracket, every Dollar you spend on equipment will actually cost the company \$1.34. Since every lease payment is tax free, \$1.00 costs \$1.00.

#### Inflation

The Dollars you have in your hand today are far more valuable than the dollars you will have tomorrow, or 5 years from now, because of what inflation is going to do to their buying power. Leasing allows you to keep your valuable Dollars and pay the leasing company back in inflated Dollars.

#### Working Capital

Dun & Bradstreet says that the average company earns approximately 12% per year on its working capital. By paying cash for equipment, a company loses this return. Additionally, many companies supplement their yearly working capital needs with a bank loan which lowers their return by the amount of the interest paid.

### Lease vs. Buy: Example !

The example below will use the following assumptions to illustrate the CASH difference between buying and leasing equipment:

- Equipment Cost: \$100,000
- Lease Term: 60 Months
- Purchase Option: 10%
- Monthly Rental: \$2248.00
- Tax Bracket: 34%
- Return on Capital: 12%

| <u>Buy</u>       |                                 | <u>Lease</u>     |                             |
|------------------|---------------------------------|------------------|-----------------------------|
| \$100,000        | Purchase Price                  | \$ 2,248         | Monthly Rental              |
| <u>\$ 34,000</u> | 34% Tax                         | <u>    x 60</u>  | Months                      |
| \$134,000        | After Tax Purchase Cost         | \$134,880        | Total Lease Payments        |
| <u>\$ 60,000</u> | Lost Return On Working Capital  | <u>\$ 10,000</u> | Purchase Option             |
| <b>\$194,000</b> | <b>Real Cost Of Paying Cash</b> | <b>\$144,880</b> | <b>Real Cost Of Leasing</b> |

### What Should I Do ?

Analyze and understand the concept presented here. Then, compare it to your business situation to see if it applies and which situation is best for you and your Company. If you agree that Leasing in most situations is the least cost method of acquiring the use of needed equipment, then please call us. We are MARKAY LEASING CORPORATION and we would welcome an opportunity to explain our programs and become your Leasing company and finance partner.

20407 Strathern Street, Canoga Park, CA 91306 (818)998-6125, 8886-Markay, (818)998-6127 fax

[www.markay.com](http://www.markay.com)    [lease@markay.com](mailto:lease@markay.com)